SMBC SMBC Group

US Macroeconomics

June 14, 2024

Joseph Lavorgna, Chief US Economist | 212.893.1528 | joseph.lavorgna@smbcnikko-si.com

The Problem With Transparency

Both the nominal and real federal funds rates are high relative to where they have been over the last two decades. However, financial conditions, in particular **equites, have offset much of the monetary tightening, which is largely due to the Fed's own communication strategy**.

The current framework of policy transparency that had begun under Chair Bernanke has continued under Chairs Yellen and Powell. Today, the Fed Chair hosts a press conference with a Q&A following every FOMC meeting. This environment could not be any more different from 20 years ago when Alan Greenspan manned the post.

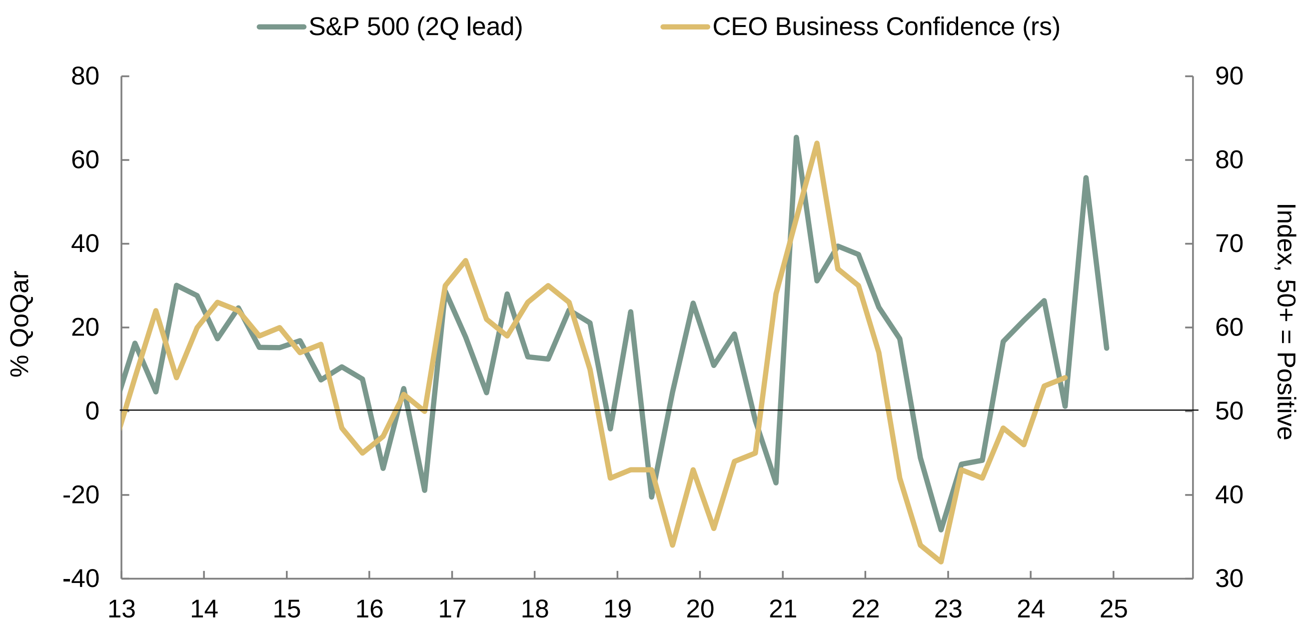
Sometimes the Fed's desire to be open with its intentions has the effect of *blunting* its desired policy outcomes. Take last December for example. Powell laid out the conditions necessary for a pivot toward less restrictive policy. This surprised investors causing bond yields to plunge, credit spreads to tighten, and stock prices to surge. Consequently, financial conditions eased dramatically, which effectively stimulated an already overheated economy. **Markets had moved in anticipation of Fed easing.**

This development complicates the Fed's goal of restoring balance between economy wide demand and supply. Perhaps this is best shown in the chart below, which shows the annualized quarterly performance in the S&P 500 versus CEO Business Confidence. The former leads the latter by two quarters.

When stocks rise (fall), CEO confidence rises (falls) but with a lag. In other words, executives become more confident once stocks have performed well for a couple of quarters. The opposite is also the case when stocks decline. This matters because the big increase in the stock market is pushing up CEO confidence, which is now above the 50 threshold and in positive territory, leading to expansionary conditions in the real economy.

While annualized stock market returns have slowed recently from their torrid pace, CEO Confidence should still improve further. This means that the demand for labor and capital are likely to be strong. In other words, because investors are front running the Fed, **equity performance could be impacting corporate behavior in a way that runs counter to the Fed's objective of slowing aggregate demand relative to supply.**

Absent a pullback in stock prices and tighter financial conditions, current market dynamics could lead the Fed to be higher for *much* longer.



Source: S&P, Conference Board, Haver, SMBC Nikko

Disclaimers

This document is provided by SMBC Group (including, collectively or individually, Sumitomo Mitsui Banking Corporation, SMBC Nikko Securities America, Inc., and their affiliates, as applicable) for informational purposes only, solely for use by the client(s) or potential client(s) to whom such document is directly addressed and delivered. This document was prepared by SMBC Group's economist(s).

This document has been prepared for and is directed at institutional investors and other market professionals, and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Group does not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion following their own independent analysis and assessment of the merits of any transaction prior to execution, after conducting a careful examination of all documentation delivered, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents. The financial instruments discussed may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views, statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Group. The trading desks of SMBC Group trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Group may conflict with those of the recipient. SMBC Group may seek to do business with the companies mentioned in this material and the trading desks may accumulate, be in the process of accumulating or have accumulated, long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to policies and procedures that apply to the globally branded research reports and research analysts of SMBC Group or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Group, and its directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.